

TEACHERS' RETIREMENT BOARD

INVESTMENT COMMITTEE

SUBJECT: Discussion and Review of the
CalSTRS Investment Objectives

ITEM NUMBER: 7

ATTACHMENTS: 4

ACTION: _____

DATE OF MEETING: June 6, 2001

INFORMATION: X

PRESENTER: Christopher Ailman

EXECUTIVE SUMMARY

Each July the Investment Branch presents the Investment Management Plan (Plan) for the coming year. This document is, in essence, the CalSTRS Investment Policy (Policy). Embedded in the Plan is a listing of the CalSTRS Investment Objectives. In preparation for the July meeting, staff would like to present some suggested revisions to the current objectives for discussion by the Investment Committee. The selection of the objectives, and the ranking of the priorities set the course for every facet of the investment program. As staff develops the Plan/Policy for 2001-2002, an understanding and discussion of the Investment Committee's overall objectives will help ensure that staff is effectively meeting the requirements of the Committee. The final Investment Plan/Policy will be formally adopted at the July Investment Committee meeting.

Background:

The identification and ranking of the investment objectives set the vision and direction for the remainder of the Investment Policy and portfolio. They serve as the mission statement for the investment portfolio. Along with asset allocation and selecting senior staff, setting the investment objectives is one of the critical assignments for the Investment Committee.

A majority of the objectives are not mutually exclusive, however, as with any major endeavor, success is usually driven by a clear mission and priority of the objectives. Striving to meet two potentially conflicting objectives, often leads to unsatisfying results as measured by either standard. Therefore, the ranking of the objectives is as important as the objectives themselves.

With the passage of Proposition 21 in 1984 and then Proposition 162 in 1992, the California Constitution Article 16, Section §17 dictates the standard of care and the first three objectives for every public pension plan in California. The remaining objectives are at the full discretion of the respective retirement boards. The current CalSTRS list has eight general objectives. After analyzing the objectives of several pension plans, staff has suggested some potential changes. The revised list of potential objectives is not exhaustive.

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Discussion:

The mission has not changed drastically over the years; the objectives do not require significant revisions. However, from time to time they have been, and need to be, refined and clarified. Given the addition of several new Board members, this is the opportune time to revisit and discuss potential changes.

Staff is suggesting that the Committee formally state the standard of care that is established by the California Constitution. This section is common in many California pension policies, and sets the tone for the investment objectives. As discussed, the California Constitution, Article 16, Section §17, establishes the first three objectives. They are: 1) Manage the assets for the exclusive purposes of providing benefits to, participants and their beneficiaries; 2) Strive to minimize employer contributions; 3) Diversify the assets so as to minimize the risk and maximize the return.

Staff has suggested that the CalSTRS objectives be revised to more clearly reflect these constitutional requirements. Within the remaining objectives there appear to be redundant language that could be consolidated. CalSTRS has also established a high priority to compare investment performance with other large funds. Staff is suggesting this be adjusted to encompass the total program. Return cannot be generated in isolation; expenses, staffing, and portfolio risk are all factors that directly affect the investment return of a given portfolio. The revised objectives incorporate this broader comparison to other large pension programs. Despite the change, looking forward there are a couple factors that may make the comparison to other funds less meaningful and more complicated than originally believed. First, there are only a handful of \$100 billion plus pension plans in the U.S.A. Second, as other pension plans mature, their cash flow and liability pattern may differ significantly from that of CalSTRS. As a result, while some general comparison is useful, it may deserve a lower ranking in than it holds current existing objectives.

There are also some effective objectives found in the policies of other Retirement Boards that the CalSTRS' Board may wish to incorporate. For example, striving to maintain and enhance the participants and public's trust in the program. In addition, there are also other types of objectives not listed that have become part of the portfolio strategies that the Board may wish to elevate to the level of an overall objective. As mentioned above, the ranking of the objectives becomes critical to setting the priorities for the investment portfolio.

Attached is a copy of the current CalSTRS Objectives, (Attachment 1), the California Constitution Article 16, Section §17, (Attachment 2), and a suggested revised 2001-2002 Objectives – marked to show the changes (Attachment 3), and last, a clean copy of the suggested revision for easier reading (Attachment 4). This item is intended to serve as a tool for discussion before the final adoption at the July meeting.